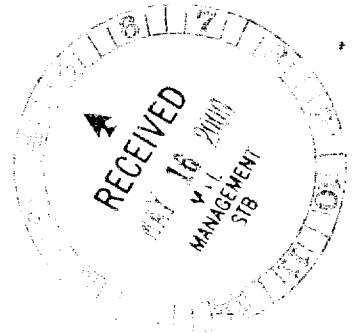


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BEFORE THE  
SURFACE TRANSPORTATION BOARD



STB Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

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**JOINT COMMENTS OF CERTAIN COAL SHIPPERS**

Otter Tail Power Company ("OTP"), Public Service Company of Colorado ("PSCo"), Southwestern Public Service Company ("SPS"), TUCO INC. ("TUCO"), Tucson Electric Power Company (TEP"), and Western Resources, Inc. ("Western") (referred collectively herein as "Joint Commenters"),<sup>1</sup> hereby jointly submit the following comments in response to the Board's Advance Notice of Proposed Rulemaking ("ANPR") issued in this proceeding on March 31, 2000. As set out in more detail in these comments, the Joint Commenters strongly urge the Board to conduct this salutary broad examination of its rules with the goal of adopting changes to the regulations that will facilitate improved service in the railroad industry by enhancing meaningful competition between the major Class I railroads.

**I.**

**Introduction**

The announcement by The Burlington Northern & Santa Fe Railway Company ("BNSF") and the Canadian National Railway Company ("CN") of their intent to merge, and the specter that this merger would trigger the consolidation of the railroad industry into two North American

<sup>1</sup> All of the Joint Commenters are Parties of Record in this proceeding.

railroads, has prompted the Board to examine its rail merger policy and regulations. This review was prompted in large part by the Board's general concern that the past three major rail mergers have not resulted in the efficiencies and improved service touted by the merger applicants in their merger proceedings, and that rail shippers had not yet recovered from such service disruptions.<sup>2</sup> The oral and written testimony of hundreds of rail shippers in Ex Parte 582, Public Views on Major Rail Consolidations, documenting how rail service nationwide has deteriorated as the railroad industry has consolidated over the past decade not only overwhelmingly confirmed the Board's fears, but also documented how the deterioration of rail service is tied directly to and rooted in the diminishment of competition between the major Class I railroads as this consolidation occurred. This cause and effect relationship between the deterioration of service and the lack of meaningful competition between the major railroads is particularly evident in the coal transportation segment of the railroad industry, and particularly in the transportation of coal from western coal mines to electric generating plants in the western and Midwestern United States.

At the conclusion of the hearing in Ex Parte 582, the Board rightfully concluded that "our current rules are simply not appropriate for addressing the broad concerns associated with reviewing business deals geared to produce two transcontinental railroads." Ex Parte No 582, Decision served March 17, 2000 at 2. These broad concerns included both service and competitive issues. *Id.* at 6. The Board also agreed that the "time has come" for it to consider whether it should revise its rail merger policy with an eye toward "enhancing, rather than simply preserving, competition." *Id.* at 4.

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<sup>2</sup> See, e.g. Finance Docket No 33842, Decision Nos. 1 and 1A (STB served December 28, 1999) at 6-7, 65 Fed. Reg. 318 (Jan. 4, 2000)

## II.

### **Identity of Joint Commenters**

Joint Commenters ship, in aggregate, over 34 million tons of coal annually from mines in the western United States to coal-fired electric generating stations located in the western and Midwestern states. In aggregate, OTP, PSCo, SPS, TEP and Western supply electricity to millions of retail electric consumers in the western and Midwestern United States, and engage in wholesale sales of electricity over the Nation's transmission grid. Each utility Joint Commenter has been directly affected by the efforts of the Federal Energy Regulatory Commission and various state agencies to restructure the electric utility industry by introducing more competition on the wholesale and retail levels. A brief description of each Joint Commenter follows:

Otter Tail Power Company is an investor owned utility headquartered in Fergus Falls, Minnesota. OTP provides electricity to over 126,000 customers in the states of Minnesota, South Dakota, and North Dakota. OTP is the operating partner in the Big Stone Plant and the Coyote Station, two coal-fired steam generation plants, and is the sole owner of Hoot Lake Plant, also a coal-fired plant. These plants burn approximately five million tons of coal per year from mines in the Western United States, and are heavily reliant upon railroads for delivery of this coal to the plants.

Public Service Company of Colorado is an investor owned utility headquartered in Denver, Colorado, and an operating division of New Century Energies. PSCo provides electricity, natural gas, and other services to over 1.4 million customers in the State of Colorado. PSCo owns and operates five coal-fired generating stations in Colorado, which burn approximately eight million tons of coal annually, all of which must be shipped by rail over the lines of the

BNSF and/or UP. Each of PSCo's coal-fired plants is presently served by only the BNSF or the UP for some or all of the routing from the mines to the plant.

Southwestern Public Service Company is an investor owned utility headquartered in Amarillo, Texas, and an operating division of New Century Energies. SPS provides electricity, natural gas, and other services to approximately 400,000 customers in Kansas, New Mexico, Oklahoma and Texas. SPS owns and operates the Tolk and Harrington Generating Stations, located in Muleshoe and Amarillo, Texas, respectively. These plants burn around nine million tons of coal each year that is presently delivered by the BNSF from mines in the Powder River Basin of Wyoming. While SPS's Harrington station enjoys some degree of rail competition due to a condition placed on the merger of the Burlington Northern Railroad Company and the Atchison, Topeka & Santa Fe Railway Company, the Tolk Station is captive to BNSF at destination.

TUCO INC. is headquartered in Amarillo, Texas, and is a wholly owned subsidiary of TUCO Holdings, Inc., which is owned by NexGen Resources Corporation and Republic Financial Corporation. TUCO is the coal provider of SPS responsible for the procurement of coal and rail transportation for SPS's Tolk and Harrington Generating Stations. TUCO purchases, and administers the contracts covering the shipment of, nearly nine million tons of coal to Tolk and Harrington annually on the lines of the BNSF.

Tucson Electric Power Company is an investor-owned electric utility headquartered in Tucson, Arizona. TEP's retail service area encompasses 1,155 square miles in Southeastern Arizona with a population of approximately 840,000. TEP also provides electricity to numerous wholesale industrial customers as well as offering electricity for sale to other utilities.

TEP owns and operates two coal fired generating stations that receive coal by rail: the Irvington Generating Station located in Tucson, Arizona and the Springerville Generating Station located in Springerville, Arizona. The Irvington and Springerville Stations together burn approximately 3.5 million tons of coal per year. The Irvington station currently burns coal from a mine near Gallup, New Mexico obtained under a long-term coal supply contract. This coal is delivered to Irvington pursuant to a rail transportation contract between TEP, the BNSF and the UP. The Irvington Station also burns some coal from Colorado mines. The Irvington Station is captive to UP at destination. The Springerville station burns coal obtained from the Lee Ranch Mine near Baca, New Mexico under a long term coal supply contract. This coal moves in BNSF single line service to Springerville. The Springerville station is captive to BNSF at both origin and destination.

Western Resources, Inc. is a consumer services company headquartered in Topeka, Kansas with interests in monitored security and energy. Western's utilities, KPL and KGE, provide electric service to approximately 620,000 customers in Kansas. Western owns several coal-fired electric generating stations that in total burn approximately 11 million tons of coal each year that must be delivered by the BNSF and UP. Western's Jeffrey Energy Center, in St. Mary's, Kansas northwest of Topeka, requires approximately nine million tons of coal each year to provide electricity to satisfy the needs of Western's wholesale and retail customers. This coal is delivered by UP and BNSF in a joint line contract movement from mines in the Powder River Basin in Wyoming. JEC's transportation is captive to BNSF at origin, and captive to UP at destination. Western's Lawrence and Tecumseh Energy Centers, located on the line of BNSF between Topeka and Kansas City, each presently burn around one million tons of coal per year

which is delivered by the UP and BNSF from mines in Colorado in joint line service. These facilities are captive to BNSF at destination.

### III.

#### Comments

**A. The Joint Commenters Strongly Endorse the Board's Broad Review of its Regulations and Policies for the Purpose of Enhancing, Not Merely Attempting to Preserve Railroad Competition**

In its March 17 decision in Ex Parte No 582, the STB agreed with the many rail shippers and other entities filing comments and providing oral testimony that the service and competitive problems with the rail industry today require that the STB's policies regarding major rail mergers must be re-examined. In so doing, the STB concluded that its current regulations are "not appropriate for addressing the broad concerns associated with reviewing business deals geared to produce two transcontinental railroads," and that it concurred with the "substantial support at our hearing for a broad review of and revision to the rules governing major rail mergers." March 17 Decision at 6. Although the Board indicated its reluctance to do "a complete overhaul" of its regulations, *id.*, it acknowledged that "a significant number of shippers stated that we need to adopt new merger rules to ensure that competition will not be curtailed further in the event that the industry seeks to merge itself into a duopoly." *Id.*

The comments and testimony submitted in Ex Parte 582 provided many "real world" examples of the reality that, despite representations to the contrary, competition and service levels have generally decreased as the railroad industry has become more consolidated. The Joint Commenters maintain this is irrefutable evidence that the overall standard applied by the Interstate Commerce Commission and the Board in prior rail mergers - attempting to preserve competitive levels existing prior to the merger - has been insufficient. The Joint Commenters

therefore wholeheartedly agree with the Board that “the time has come for us to consider whether we should revise our rail merger policy, as many have suggested with an eye toward affirmatively enhancing, rather than simply preserving, competition.” ANPR at 4. (emphasis supplied).

The Nation’s rail system and the service provided over it will only improve if the few remaining railroads have incentives to make the investments and innovative changes that best arise out of an industry where the players are driven by competition. Merely trying to preserve the status quo in a rail industry which essentially consists of a duopoly in the west with BNSF and UP, and a duopoly in the east with NS and CSX, will do little more than continue a downward spiral. The Board is correct that the present and probable future level of consolidation in the rail industry requires the Board to take measures to enhance competition as additional consolidation occurs. This will in turn spawn innovation and market-based actions on the part of the industry to improve rail service and the industry as a whole. However, Joint Commenters add that in the western United States, where a rail duopoly already exists for coal transportation, such measures should apply to both BNSF and UP, not just the railroad that next decides to merge with another carrier.

**B. The “Merger Rules” to Be Reviewed and Changed Go Beyond The Regulations Promulgated Specifically for Rail Mergers**

While in the ANPR the STB referred to its “merger rules” and appears to define such rules as the regulations found at 49 CFR Part 1180.0 - 1180.9, the serious issues raised by parties in Ex Parte 582 and highlighted by the STB in the ANPR require review of other, related STB regulations and rules established through adjudication, as well. This is particularly true if the policy objective of revisions to the applicable regulations is to enhance railroad competition.

This policy objective cannot be realized if pro-competitive regulations are adopted for limited application to a merger consolidation. The result would be an unbalanced rail industry, where the merged railroad would be required to provide rates and service its competitors do not have to provide under the Board's current regulations and decisional rules. Examples include (1) Part 1144, Intramodal Rail Competition; (2) Part 1146, Expedited Relief for Service Emergencies; (3) Part 1147, Temporary Relief Under 49 U.S.C. 10705 and 11102 for Service Inadequacies; and (4) the Board's so-called "Bottleneck Rules."<sup>3</sup> Failure to review and revise these and other rules along with changes made to rules applicable in the merger context will not only create an unbalanced rail industry, it will provide a disincentive for railroads to merge at all. In summary, a broad review of all the Board's rules related to rates and service needs to be conducted for the purpose of establishing whether the rules will facilitate improved rail service and meaningful competition as the railroad industry continues to consolidate.

**C. Specific Regulatory Changes That Should be Included in the Notice of Proposed Rulemaking to Facilitate Improvements in the Rail Industry Through Competition**

**1. Require Merging Railroads to Provide, Upon Request, Rates over "Bottleneck" Railroad Segments That Are Created By the Merger and Pre-Existing Bottleneck Segments on the Merging Railroads**

Despite the fact that there is a potentially pro-competitive component of the Board's Bottleneck Rules, since their adoption these rules have generally resulted in decreased competition and service to captive coal generation stations. These rules must be revised if rail competition for coal transportation is to improve as the industry continues to consolidate. The

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<sup>3</sup> The term "Bottleneck Rules" refers to the rules adopted by the Board in Central Power & Light Co. v. Southern Pac. Transp. Co., Nos. 41242, et al. (Dec. 31, 1996), clarified (Apr. 30, 1997), aff'd sub nom. MidAmerican Energy Co. v. STB, 169 F.3d 1099 (8<sup>th</sup> Cir. 1999), reh'g denied (Apr. 20, 1999), cert. denied sub nom. Western Coal Traffic League v. STB, 120 S. Ct. 372 (1999); Union Pac. R.R. v. STB, No. 98-1058 (D.C. Cir. Feb. 15, 2000) ("Bottleneck Decisions").

STB should promulgate regulations that require merger applicants to provide rates and service terms upon request over all bottleneck segments of track in cases where (1) the merging railroad combines with a bottleneck railroad, thereby acquiring the full routing from an origin to a destination; and (2) there is an existing bottleneck on either of the merger applicants' systems where there is a current interchange between the merging carriers. Related changes to the Bottleneck Rules are discussed below.

- a. The Board's use of the "one lump theory" to deny relief to shippers in the context of rail mergers is inconsistent with the Bottleneck Rules

The STB should use the NOPR as a means to resolve the inconsistency between the so-called "one lump theory" it has used to deny relief to captive shippers in the railroad merger context and the "contract exception" to the Bottleneck Rules. More specifically, both the BN/Santa Fe merger and the UP/SP merger resulted in the merged railroad obtaining a monopoly over a bottleneck segment of track owned by a previously neutral carrier and the remainder of the movement from origin to destination. In these circumstances the Interstate Commerce Commission ("ICC") and the STB denied the requests of the captive coal shipper for relief from the extension of the bottleneck carrier's monopoly. This denial was based on the theory that the level of the harm to the shipper after the merger was no different than the harm existing prior to the merger, because there is only one "lump" of profit to be had on the overall movement, and the monopoly destination carrier would absorb the lion's share of that profit regardless of whether or not it merged with an upstream carrier.

However, in the Bottleneck Decisions, the Board explicitly found that, if a coal shipper is able to obtain a contract for the movement of its coal by a non-bottleneck carrier from a different mine origin than that served by the incumbent carrier, the Board will prescribe a maximum

reasonable rate over just the bottleneck portion of the movement. This prescription effectively prohibits the bottleneck carrier from, as the “one lump theory” assumes, “soaking up” all the profit remaining on the overall movement after the non-bottleneck carriers compete for that portion of the movement. Accordingly, if the STB were to continue to adhere to the “one lump” theory in rail mergers, to the extent a merger results in the railroad with the bottleneck serving the same origin as a potential competitor over the non-bottleneck segment, the “contract exception” would cease to be available to the captive shipper.<sup>4</sup>

- b. The Board should strengthen the ability of coal shippers to achieve the intended benefits of the “contract exception” to the bottleneck rules by (i) eliminating the “same origin” restriction, and (ii) requiring merging carriers to provide separately challengeable rates over bottleneck segments even if no contract exists for the non-bottleneck segment.

In the Bottleneck Decisions, the STB determined that a railroad need not provide a rate over a bottleneck segment if the bottleneck railroad and the non-bottleneck railroad that wishes to contract with the shipper for service over the non-bottleneck segment serve the same origin. This “same origin” restriction discourages most shippers of coal from Western coal mines from even attempting to obtain a contract for service over non-bottleneck segments. The reason is simple: many key mines in the west, particularly mines in the Wyoming Powder River Basin, are served by both UP and BNSF, and thus the STB will not even entertain a request that a bottleneck rate be prescribed until a coal shipper successfully prosecutes a competitive access case at the STB. This “same origin” restriction should be eliminated.

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<sup>4</sup> In the Bottleneck Decisions the STB allowed that a captive shipper precluded from obtaining a rate via the “contract exception” because of the same origin restriction could still attempt to obtain such a rate by filing a competitive access case with the STB establishing a more efficient interchange. However, even though the STB expressly acknowledged the fact that the hurdles for prevailing in such a case under the Board’s current rules are prohibitively high, it gave no specifics as to any different standards that would apply to a competitive access case arising in a bottleneck situation. Thus, no captive shipper has filed a competitive access case at the Board since the Bottleneck Rules were adopted.

Second, the fears of utilities and other entities that a two carrier system in the West would not result in vigorous competition for captive traffic under the bottleneck rules have proven to be justified. Neither UP nor BNSF have actively sought to enter into competitively-priced contracts for transportation over non-bottleneck segments where the other railroad holds a monopoly over a bottleneck segment. The Board should reconsider its refusal in the Bottleneck Decisions to require railroads to provide rates over bottleneck segments of track even if no contract is present for transportation above or below the bottleneck. The absence of competitively priced contracts for non-bottleneck segments gives credence to the position of numerous shippers in the Bottleneck Proceedings that the pro-competitive goals of the “contract exception” will only be reached if the bottleneck carriers are required to provide the rate first.

**2. Establish Remedies In The Event That Service Declines After a Rail Merger, and Provide for the Substitution of Rail Service by Another Railroad on More Lenient Grounds.**

Recent mergers have frequently resulted in substantial reductions in rail service levels to shippers after the merger was approved by the STB. Particularly as a result of the severe problems of the UP in implementing its merger, coal shippers and electric utilities suffered losses and damages in the many millions of dollars. Some of the Joint Commenters and other electric utilities outlined their specific circumstances to the Board in testimony submitted in Ex Parte 582. In general, however, most coal-fired generating facilities can normally withstand not more than 30-45 days of deteriorated service before their coal inventories are depleted. Moreover, the Board must realize that, in the event of such deterioration, it is not enough for service levels to be restored to prior levels. Rather, service must be restored to a greater level to quickly build inventories back up to levels that provide adequate insurance that electric power will be supplied to wholesale and retail customers in the event of future rail service deterioration.

Notwithstanding this need for improved service as a result of a major rail merger, the Board's present merger policy and regulations permit a certain level of service deterioration after a merger before the STB will act, and the Board has to date afforded railroads a substantial degree of deference in their representations regarding their ability to return service levels to pre-merger levels. This policy unfairly places a large amount of the risk that merging railroads cannot effectively implement their merger on the shoulders of rail customers. The Board's policies and regulations need to be changed to require more scrutiny of representations regarding service made by merger applicants, and less deference to merging railroads regarding rail service issues post-merger. In short, the Board should adopt and implement a policy of aggressively requiring the railroad industry to quickly improve overall service levels as the industry becomes more consolidated. Some elements that should be included in the NOPR to help achieve this result are summarized below.

- a. The Board should adopt rules requiring a merging railroad to specify service levels that will exist post-merger, and to specify beforehand actions that will be taken if service levels deteriorate.

The testimony of hundreds of shippers in Ex Parte 582 clearly affirmed the major Class I railroads' track record of failure in fulfilling their representations regarding improvements in service as a result of their respective mergers. This track record, coupled with the size of the stakes in the event a subsequent merger results in widespread service failures, makes it entirely appropriate for the Board to adopt regulations that require merging carriers to specify in the merger application what service levels are expected to exist on the merged carrier, and to state what actions the merging railroads will take if service levels deteriorate. Such a requirement would place the burden on merger applicants to convincingly and specifically demonstrate

during the application review process how they intend to deal with post-merger service problems, subject to penalties for failure to do so.

- b. The Board's regulations should permit penalties to be assessed against merging railroads for measurable reductions in rail service post-merger.

The Board's current merger policy effectively permits a degree of service deterioration after a rail merger before the Board will even consider penalizing merger applicants. In an industry where only two major rail providers exist west of the Mississippi and the nation is rapidly moving toward only two rail providers in North America, the STB should have regulations that penalize the major rail carriers for any measurable reduction in service to shippers after a rail merger. In light of the past failures of merging railroads to accurately predict when service problems will cease, the Board should not refrain from penalizing merging railroads based on their unsupported representations that service levels will soon return to normal.

In conjunction with modifying the rules regarding service in the context of rail mergers as outlined above, the Board should similarly amend its service rules published at 49 CFR Parts 1146 and 1147. These rules put the onus on the petitioner to demonstrate that the service problems it is complaining of will not be rectified by the incumbent carrier "within a reasonable period of time." 49 CFR § 1146.1(b)(1)(ii) and § 1147.1(b)(1)(ii). The rules also require the petitioner to have an agreement in place with an alternative carrier and to demonstrate that the alternative service can be provided without degrading service to other customers of the incumbent and without "unreasonably interfering with the incumbent's overall ability to provide rail service." 49 CFR § 1146.1(b)(1)(iii) and § 1147.1(b)(1)(iii).

In order to advance a policy of improving rail service by enhancing competition and not tolerating any reductions in overall rail service as the industry continues to consolidate, the Board must amend these rules to (1) permit relief for any measurable reduction in rail service; (2) put the burden on the incumbent railroad, to rebut a presumption that alternative service will not interfere with its operations; and (3) impose penalties in the form of damages, including consequential damages, incurred as a result of the service deterioration.

**3. Permit Reciprocal Switching and Trackage Rights from Terminal Points to Facilities Physically Connected to Only One Major Railroad**

Another regulatory change that the STB should include in the NOPR is a presumption in rail merger cases in favor of reciprocal switching at a single rate in a terminal – and a reasonable distance beyond the terminal - for all connecting carriers. In setting the level of the rate, the Board should give substantial consideration of switching rate levels that enhance the competitive options available to shippers while covering the railroads’ costs. Agreements between railroads regarding the level of the charge should be considered, but accepted by the Board only if the agreed-upon level enhances the feasible options of rail shippers after the merger.

Consistent with the above regulation and the policy goal of enhancing railroad competition in order to improve the industry as a whole, the Board should amend its competitive access regulations promulgated at 49 CFR Part 1144 to ease the criteria for a shipper to receive reciprocal switching and/or terminal trackage rights to a captive facility from interchanges within a reasonable distance from terminal areas served by the railroad and another carrier with the ability to provide rail service to the captive facility. Such rules would complement the rules requiring the establishment of rates over bottleneck segments of the merging railroads’ track. The Board should explicitly overrule the “competitive abuse” standard for relief enunciated in its

Midtec decision, and publish rules that establish that the appropriate standard is a “public interest” standard, consistent with the statutory language. The requirement in § 1144.5(a)(1)(i) that there be an anticompetitive act before prescription can occur should be eliminated.

**4. Ensure the Viability and Independence of Short Line, Regional and Smaller Class I Carriers as Competitive Alternatives to Major Class I Railroads for Coal Transportation.**

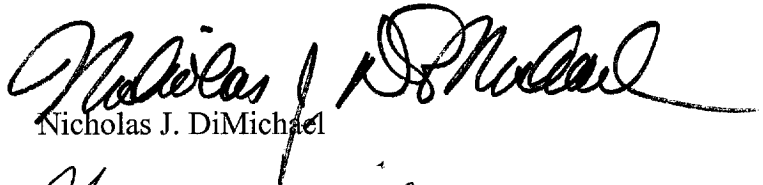
As the number of major railroads becomes fewer and their individual market power becomes more concentrated, it will be essential for the Board to ensure that smaller Class I and regional railroads are able to provide competitive alternatives to the major railroads for rail transportation at locations where such competition is operationally and economically feasible. The presence of such competitive alternatives will advance the policy of improving rail rates and service through competition. Some of the measures that should be included in the NOPR are regulations designed to (1) target and eliminate non-competitive “paper barriers” erected by major Class I railroads as part of the sale of a particular rail line as an outgrowth of a merger; (2) closely scrutinize the operating plans of merger applicants for evidence of intent to close interchanges and connections with short line railroads for anti-competitive reasons; and (3) facilitate the use of smaller Class I railroads and regional short lines as alternatives to incumbents in the event of service disruptions, even if such service is over the track of the incumbent railroad. In adopting and implementing such regulations, the STB must be cognizant of the market power major Class I railroads have over short line railroads.

IV.

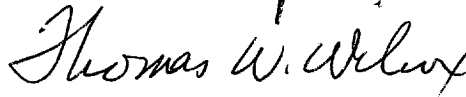
CONCLUSION

In conclusion, Joint Commenters agree with the Board's conclusion that its regulations are insufficient to address the issues associated with a two carrier rail system, and applaud the Board's review of its regulations with the aim of considering modifications that enhance competition in the rail industry. Joint Commenters ask that the suggestions made hereinabove be incorporated into the Notice of Proposed Rulemaking to be issued in this docket.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Nicholas J. DiMichael".

Nicholas J. DiMichael

A handwritten signature in black ink, appearing to read "Thomas W. Wilcox".

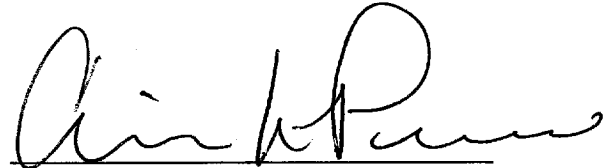
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May 16, 2000

**CERTIFICATE OF SERVICE**

I hereby certify that I have served on this 16<sup>th</sup> day of May, 2000 a copy of the above  
Comments by first class mail postage pre-paid, to all parties of record.

A handwritten signature in cursive script, appearing to read 'Aimee DePew', written over a horizontal line.

Aimee DePew